

THEY MUST BE STOPPED!

THE WALL STREET JOURNAL FRIDAY, JANUARY 11, 2002

CORPORATE FOCUS

Sears Estimates 11% Increase in Fourth-Quarter Earnings

Investors Welcome CEO Lacy's Emphasis on Improved Profitability in Turnaround

By Kevin Helliker
Staff Reporter of THE WALL STREET JOURNAL

Clearly, investors are expecting profit growth, and yesterday Sears delivered. The retailer said it anticipates reporting an 11% jump in fourth-quarter earnings per share before extraordinary items, to about \$2.02—11 cents above the Thomson Financial/First Call consensus estimate of \$1.82.

The news sent Sears stock surging even higher. In 4 p.m. New York Stock Exchange composite trading, Sears rose \$2.28, or 4.6%, to \$51.73, a 52-week high.

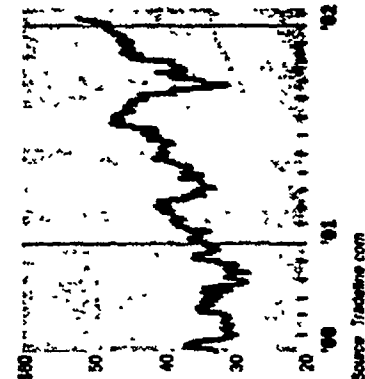
The vote of investor confidence is rallying to Alan Lacy, the onetime chief financial officer who became Sears's chief executive about 15 months ago. But he recognizes that the fundamental challenge is to win shoppers, not investors.

In a retail landscape impaled with newer and faster-growing chains touting lower prices, greater convenience and broader selections, it is no clutch to persuade shoppers to keep haunting 115-year-old Sears. Even as fourth-quarter operating earnings rose, December sales at stores open more than a year fell 2.4%.

"We have several years of very hard work ahead of us," said Mr. Lacey at Sears

Rallying Retailer

Daily closing price of Sears stock on the New York Stock Exchange, adjusted for splits and spinoffs



headquarters in this Chicago suburb.

Mr. Lacy, 48, is the latest in a series of CEOs to try repositioning the department-store chain. One predecessor transformed Sears into a conglomerate, a strategy that ended in a flurry of unit sales. Another, former Saks Fifth Avenue executive Arthur Martinez, tried converting Sears—famous for selling batteries, tools and appliances—into a house of trendy apparel, even staging a fashion show in Manhattan. That strategy didn't work either.

Mr. Lacy isn't attempting anything so drastic. Instead of reinventing Sears in a way that might spur revenue growth, he is following the lead of other retailers by eliminating costs and evaluating every product and service in the company, scrap-
ping any that aren't satisfactorily profitable. His goal, stated in October, is to increase operating profit by 50% by '04.

"For the first time, Sears has someone in charge who is more focused on return on invested capital than merchandising," says Wayne Hood, Prudential Securities retail analyst, who recommends buying the stock despite the expectation that revenue won't rise during 2002. Per-share earnings will, though, to \$4.80 from \$4.22, Mr. Hood expects.

The review of products and services has Mr. Lacy professing no certainty as to how a Sears store might look in five years. He doesn't know all the products and services that may follow bicycles and floor coverings out the door. Nor does he seem certain of the exact direction of growth. But he is certain that improved profitability is the right first step. "What I'm striving for is a retail operation that is the best in class for profitability," he says. "That's what's going to open up opportunity."

Among other things, fatter profits might make it easier for Sears, whose department stores reside primarily in regional malls, to open free-standing stores, which many consumers find more convenient. That strategy—used by highlighting Wal-Mart Stores Inc. and Kmart's Corp.—re-

quires a greater capital investment, Mr. Lacy says. "If you don't have a pretty powerful financial model, stores don't work off the mail," he says.

At Sears, selling, general and administrative costs as a percentage of sales exceeded 21%, compared with about 16.5% for Wal-Mart. Mr. Lacy suggests that Sears never may equal Wal-Mart in that department, because Sears isn't a pure retailer. Sears offers repair services and runs a credit-card operation that accounted for 68% of profit in 2000, according to a Lehman Brothers report.



Align with

lining a hodgepodge of private-label brands and apparel departments, seeking to create a simpler, more classic casual offering.

In a reversal of his predecessor's strategy, he is re-emphasizing so-called hard lines such as Craftsman tools and Kenmore appliances. The retailer recently opened three freestanding Sears appliance and electronics stores, a concept that could become a 100-unit chain.